



VOICE OF INDEPENDENT BROKER-DEALERS
AND INDEPENDENT FINANCIAL ADVISORS

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VIA ELECTRONIC MAIL

July 18, 2007

Barbara Z. Sweeney
NASD
Office of the Corporate Secretary
1735 K Street, NW
Washington, D.C. 20006-1506

RE: Proposed Joint Guidance Regarding the Review & Supervision of Electronic Communications

Dear Ms. Sweeney:

On June 14, 2007, the NASD issued Notice to Members 07-30¹ (NtM 07-30) that requested comment on proposed joint guidance from the NASD and NYSE (SROs) regarding the review and supervision of electronic communications (Joint Guidance). The proposed Joint Guidance sets forth principles for members to consider when developing supervisory systems and procedures for electronic communications that are reasonably designed to achieve compliance with applicable federal securities laws and self-regulatory organization rules. The Joint Guidance also describes certain best practices that firms should consider adopting to achieve compliance. The Financial Services Institute² (FSI) appreciates this opportunity to comment on the Joint Guidance.

Background on FSI Members

The independent broker-dealer (IBD) community has been an important and active part of the lives of the American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice with little, if any, proprietary product bias,³ while avoiding some of the pitfalls to which other financial service business channels have been susceptible in recent years. IBD members also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products, by "check and application"; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment advisor firms or such firms owned by their registered

¹ See NtM 07-30 at

http://www.nasd.com/RulesRegulation/NoticestoMembers/2007NoticestoMembers/NASDW_019298.

² The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed in 2004. Our members are broker-dealers, often dually registered as federal investment advisers, and their independent contractor registered representatives. FSI's 110 Broker-Dealer members have more than 130,000 registered representatives serving more than 14 million American households and generating in excess of \$13.7 billion in annual revenues. FSI also has more than 7,800 Financial Advisor members.

³ Please note that there are some large independent broker-dealer firms who offer proprietary products such as mutual fund, variable annuity, and/or investment advisor products offered by an affiliated or parent insurance company, broker-dealer or investment advisor. Nevertheless, these IBD firms, and their proprietary products, represent the exception to the rule.

representatives. Due to their unique business model, IBDs and their affiliated financial advisors are especially well positioned to provide middle class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 105,000 independent financial advisors – or approximately 20 percent of all registered representatives – practice in the IBD channel.⁴ These financial advisors are independent contractors, rather than employees of the IBD firms. Independent financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisors are typically “main street America” – it is, in fact, almost part of the “charter” of the independent channel. The core market for advisors affiliated with IBDs is clients with a net worth of \$250,000. Independent financial advisors are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence. Independent financial advisors get to know their clients personally and provide them investment advice in face-to-face meetings – oftentimes over the client’s kitchen table. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisors have a strong incentive to make the achievement of their clients’ investment objectives their primary goal.

The proposed Joint Guidance is of particular interest to FSI and its members. FSI believes the Joint Guidance achieves the stated regulatory objective of providing helpful guidance to firms who are developing supervisory systems and procedures that are reasonably designed to achieve compliance with applicable federal securities laws and SRO rules. Given the rapid pace of technological innovations in electronic communications, and the breadth of possible communications subject to review, FSI believes it is appropriate for the SROs to provide firms with the flexibility to develop, within a defined regulatory framework, appropriate policies and procedures tailored to their individual business models. FSI, therefore, generally supports the Joint Guidance and commends the SROs for taking a principles-based approach to the supervision of electronic communications. However, FSI does offer the following recommendations intended to better serve the principles-based approach of the Joint Guidance while preserving the SROs’ overriding objectives.

Specific Recommendations

1. Replace Term “Employee” with “Associated Person” – The Joint Guidance makes extensive use of the term “employee” to describe persons whose electronic communications must be supervised. In footnote six, the Joint Guidance clarifies that the term “includes all associated persons.”⁵ FSI believes this clarification is far too important to relegate to a footnote. As a result, FSI would encourage the SROs to amend the proposal by replacing the term “employee” with “associated person” throughout the Joint Guidance.
2. Clarify Expectations Concerning Member Policies Relating to Personal Computer Usage – In footnote eleven, the Joint Guidance indicates that “the SROs expect members to

⁴ Cerulli Associates, “Trends in the IBD Marketplace,” December 2004. Please note that this figure represents a conservative estimate of independent financial advisors. In fact, more than 130,000 financial advisors are affiliated with FSI member firms.

⁵ See page 12 of NtM 07-30 at

http://www.nasd.com/RulesRegulation/NoticestoMembers/2007NoticestoMembers/NASDW_019298.

prohibit, through policies and procedures, communications with the public from employees' home computers unless the member is capable of supervising and retaining such communications." FSI believes it is both unrealistic and unreasonable to prohibit associated persons from using their own computers for personal e-mail messages as the plain language of the footnote appears to require. As a result, this language should be modified to state that "the SROs expect members to prohibit, through policies and procedures, communications with the public concerning the member's investment banking or securities business from employees' associated persons' home computers unless the member is capable of supervising and retaining such communications."

3. Examination Staff Training – As stated above, FSI commends the SROs for taking a principles-based approach to the supervision of electronic communications. Among other benefits, this approach allows member firms the flexibility to design supervision systems and procedures that are well suited for their business model and evolving electronic communications technology. However, while principles-based guidance has many virtues, the approach does have certain inherent weaknesses. One such weakness is that the examination process may result in the subtle evolution of guidelines into "rules" without advance notice to member firms. This is especially likely when the principles-based guidance is particularly detailed and provides best practices suggestions that can be easily converted to "rules" by examiners seeking clarity. The process of "regulation creep" undermines the fundamental requirement of principles-based regulation – member firms must have the ability to accurately predict whether or not their actions constitute a breach of the principles-based guidance. When this requirement of predictability is met, it is legitimate for consequences to follow non-compliance. However, when consequences become unpredictable the principles-based approach fails and rulemaking by enforcement takes over.

FSI fears that there is the potential for the SROs' examination staff to enforce the Joint Guidance, and the best practices described therein, as if they were regulatory mandates. This could have particular impact on FSI members as certain best practices recommendations included in the Joint Guidance are simply unworkable in the independent business model. One such example is the recommendation to use technological steps to block access to certain e-mail platforms, message boards, or other Internet based electronic communications mechanisms.⁶ Independent financial advisors affiliated with IBD firms purchase, configure and maintain their own computer systems and networks. They also contract with an Internet service provider of their own choice for Internet access. These business realities directly impact IBD firms' ability to implement the Joint Guidance's best practices recommendations relating to blocking access to external e-mail platforms, message boards or other forums for electronic communication. As a result, IBD firms will need to utilize other methods to deal with these compliance issues. Examination staff members should not interpret the failure to adopt these and other best practices as a failure to comply.

As a result, we urge the SROs to consider undertaking the following initiatives:

- Remind their examination staff that the Joint Guidance sets forth guiding principles and best practices – not regulatory mandates.

⁶ Ibid at pages 6 and 7.

- Provide their examination staff with regular training concerning the various business models utilized by member firms with a focus on the impact these models may have on the legitimate supervision systems adopted by the firms.
- Commit to providing advance notice to member firms of any changes in interpretation of the Joint Guidance through Notices to Members, amendments to the Joint Guidance or rule making.

Conclusion

FSI is committed to constructive engagement in the regulatory process and, therefore, would welcome the opportunity to work with you to find solutions to these concerns that achieve your objectives without the unintended consequences we have outlined above.

Again, thank you for the opportunity to comment on the Joint Guidance. Should you have any questions, please contact me at 770 980-8487.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Dale Brown", written in a cursive style.

Dale E. Brown, CAE
President & CEO

pc: Mary L. Schapiro
Elisse B. Walter
Marc Menchel